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HOW TO PREVENT CASH SUSPENSION BY BANKS¹

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IN 1873, 1893, and 1907 the banks of New York, the financial center of the United States, suspended cash payments for a considerable length of time, throwing labor out of employment and paralyzing general business. In European countries, on the other hand, general bank suspensions have been unknown for more than half a century. What is the cause of this striking difference? Europe has practically abolished the issue of currency by banks generally, except for one great central bank in each nation, while we have maintained 7,000 separate banks of issue, each undertaking to keep up its own cash reserve. The world's experience indicates clearly that for relief from our barbarous and intolerable banking and currency conditions we must look to the operations of a national reserve bank.

Let us compare briefly European and American conditions as they exist today. The progressive nations of Europe issue currency chiefly through great central banks, whose immense coin reserves make their notes practically gold certificates payable on demand. They are practically banks of issue and not of deposit. The problem of elasticity is solved by permitting the banks to put out relatively small uncovered issues upon conditions that insure their automatic retirement as soon as the extraordinary demand for money ceases. The following table gives approximately, in millions of dollars, the capital, circulation, deposits, specie holdings, and loans of the great European banks of issue :

¹The substance of an address delivered before the Colorado Bankers' Association, contributed as a part of the discussion at the National Monetary Conference, Nov. 11, 1910.

	Capital	Circulation	Deposits	Total specie	Loans
Imperial Bank of Germany . . .	29	413	149	211	345
Bank of Austria-Hungary . . .	24	376	31	299	189
National Bank of Belgium . . .	10	136	16	24	124
National Bank of Bulgaria . . .	2	8	17	7	11
National Bank of Denmark . . .	7	34	1	27	13
Bank of Spain	29	305	134	200	154
Bank of Finland	2	18	4	5	11
Bank of France	35	1,008	189	903	255
National Bank of Greece	4	23	23	1	21
Bank of Italy	29	213	90	152	91
Bank of Naples	12	66	16	32	34
Bank of Sicily	18	14	10	9	10
Bank of Norway	3.5	21	1	8	12
Bank of the Netherlands	8	113	2	57	59
Bank of Portugal	15	74	29	13	26
National Bank of Roumania . . .	5	43	.	15	25
Imperial Bank of Russia	28	599	116	451	208
Bank of England	71	146	280	187	156
National Bank of Servia	1.1	6	1	4	2
Royal Bank of Sweden	12	52	12	20	37
Total, twenty banks	344.6	3,667	1,121	2,625	1,783

Comparing these European banks of issue with the national banks of issue in the United States, we get the following results, again expressed in millions of dollars:

	20 European Banks	7,007 U. S. National Banks
Deposits	\$1,121	\$7,098
Circulation outstanding	3,667	667
Total demand liabilities . . .	\$4,788	\$7,765
Coin reserves held	2,625	628
Percentage of reserves to demand liabilities	54	8

Note that the great issuing banks of Europe hold 54 % of demand liabilities in coin, as against only 8 % in the United States.

Mark also the fact that the 2,525 millions of dollars in coin reserves of those banks will liquidate more than twice over the 1,121 millions of deposit liabilities, a large part of which are government deposits, while the balance consists of reserves of

the non-currency-issuing banks. Distrust of the great central banks in Europe is unknown, therefore the immense cash reserves are not called upon either to pay depositors or to redeem note issues. The cash reserves are used to relieve, in times of stress, the non-currency-issuing banks with small cash reserves and large deposit liabilities. Clearly, these central banks do not monopolize the general banking function as many suppose. The small number of outside banks now allowed to issue currency are unimportant. In each country one great issuing bank acts like the governor of an engine, expanding and contracting its issue automatically without engendering distrust, because it has immense coin reserves and quick assets. Even Japan and Switzerland have lately adopted the same method of relief. The great banks, with immense capital, great coin reserves and small deposit liabilities, easily expand currency issues to meet seasonal demands, and under panic conditions "discount freely to all solvent parties"; they also furnish extra cash to banks to meet the insane demands of frightened depositors, thus preventing the general paralysis of trade and industry so destructive to labor and capital alike which is inevitable if forced liquidation takes place, as occurred here in 1907.

If the United States in 1907 had had a large central bank of banks, I am firmly convinced that notwithstanding the colossal pyramid of credit which we had been building we might have been let down by easy stages, instead of falling off from the top of the structure with a jar that shook the whole commercial world. If, on the other hand, Congress had authorized national banks to issue uncovered credit currency as some have advocated, I am equally convinced that when the panic of 1907 struck us our troubles would simply have been doubled, for we should have entered upon the critical period with a credit inflation even greater than that which we actually did face. What is "uncovered currency"? It is currency issued by banks in excess of coin held on hand. For the past three years the uncovered currency of the three leading nations abroad has been as follows: Great Britain, \$125,000,000; France, \$125,000,000; Germany, \$200,000,000; total for the three, \$450,000,000. The uncovered currency of the United States of late years has

been double this total, or \$900,000,000. Our 700 millions of silver exceed the uncovered currency of the above three nations combined; as this great sum is over half fiat it ought to be counted as partly uncovered currency.

Such vast quantities of uncovered currency and semi-fiat money have undoubtedly added slightly to the burden of high prices in the United States. They mean inflation without corresponding contraction. The world's gold production of the past thirty years has exceeded that of the previous four hundred; this is doubtless another contributory cause. In my judgment, our wonderful energy and prosperity, coupled with the great underlying law of supply and demand, is the principal cause of high prices, but currency inflation is accessory thereto. Let us therefore eliminate currency inflation by adopting the European method of concentrating reserves and note-issuing powers.

If we examine the foreign investments and trade of the four countries mentioned above, a further interesting comparison emerges. It is estimated that the people of Great Britain have invested abroad \$15,000,000,000; France, \$7,500,000,000; Germany, \$5,000,000,000. On the other hand our foreign debts probably exceed our investments abroad. The latest annual trade statistics show, in millions of dollars:

	Imports	Exports
Great Britain	2,887	1,836
France	1,176	1,017
Germany	1,980	1,607
Total for the three	6,043	4,460
United States (1909)	1,312	1,663

It will be seen from the foregoing that with such vast sums due to Great Britain, France and Germany on investments abroad, the raising of interest rates in any one of them automatically relieves shortage of funds in that nation, because investments abroad that are continually falling due are called in, instead of being renewed. Also, as bills of lading attached to time drafts on foreign imports and exports aggregating over 10,500 millions of dollars per annum or approximately 900

millions per month, are sought by banks all over Europe, these bills immediately move to the market where the rate for money is lowest, and thus funds flow freely from the easy money markets of Europe to the tight ones. The raising and lowering of interest rates thus automatically relieves pressure in Europe in normal periods, and the central banks issue extra currency in times of extraordinary demand.

The United States is not now a creditor nation, although she has made strides in that direction during the past twenty years. Our foreign trade is only 3,000 millions of dollars per annum, which in comparison with the European countries named, affords but partial relief on documentary bills of lading. The Aldrich-Vreeland bill, though perhaps of material value to us in times of crisis, does not satisfy the demands for seasonal currency. All these are reasons why the United States should have a national reserve bank as a preventive of trouble. Europe has attained elasticity by an evolutionary process, without producing distrust or inflation. Let us adopt the good features of her system and reject the bad ones. Centralized reserves and note issue we need; to branch banking I am unalterably opposed.

As an alternative to a central bank, some eminent writers advocate a zone system of note issue, controlled by boards in various sections of the country. I fear that they have not carefully considered the great cost of maintenance, nor the fact that the operation of such a system is not automatic. Is there not fear also that it would be the forerunner of a general branch-banking system?

Professor O. M. W. Sprague, of Harvard University, in a series of articles in the *Quarterly Journal of Economics* (1909-1910), points out a method of attaining elasticity and avoiding cash suspension in the United States. He believes that banks should pay no interest on deposits by other banks, and that they should at all times hold larger cash reserves than at present in order to meet extra demands in abnormal periods. Though agreeing with the major part of Professor Sprague's able argument, I am forced to disagree with him on both these points. However desirable it might be to prevent the banks from paying interest on bankers' balances, the experience of a half-century has proved it impossible.

In the second place, the banks of Great Britain, France and Germany, excluding the central banks of issue, hold less than half the cash reserves held here. Why increase the idle capital to be held for 10 or 20 years waiting to be used for perhaps three months when panic threatens?

The report of the comptroller of the currency for 1909 gives the cash held by all the banks in the United States (in fact largely in the reserve cities) as about \$1,450,000,000. 50 % increase would add \$725,000,000; \$725,000,000 idle capital at 5 % means a loss per annum of \$36,250,000. For 20 years it would mean \$725,000,000. This is a pretty penny to pay for a cure that would probably fail to work when panic threatened because at such a time each bank, just as it does now, would hold tenaciously to its cash; self-preservation is the first law of nature.

Such a plan would impound cash that ought to be in use, and it would be a great hardship to the stockholders. Besides, in obtaining the extra gold we should disturb the world's financial equilibrium.

If concentrated cash reserves enabled European banks to help us in 1907 with \$100,000,000 of gold, when every student knows that general bank reserves there were much less than here, why should we stand continuous heavy losses on increased scattered reserves? Why import vast sums of gold, instead of consolidating part of our reserves into a central reserve bank? Such a bank by increasing its circulation temporarily can aid any section of the country in the day of trouble, without loss or material cost to any interest. It thus avoids the large expense of foreign transfers, which seriously unsettle the world's exchanges, and it also obviates the calamitous results of suspension of cash payments. A bank of issue like the Imperial Bank of Germany avoids useless lock-up of cash and automatically expands and contracts its issues to meet emergencies whenever and wherever they arise. This is not theory. It is demonstrated fact. While we were floundering in the slough of despond in 1907, though Germany was in a no less expanded condition as to credit than we were, yet the extraordinary issues of the great Imperial Bank, carrying a 5 % tax, were generously

loaned to solvent parties at high rates of interest, and thus relief was brought to German business interests, which did not suffer the collapse that followed in the United States.

Why not adopt the method proved by the world's experience to be the best? Branch banking we should reject as entirely unnecessary and unsuited to our conditions. What we need is a national reserve bank, and I submit the following tentative suggestions for its organization.

1. Capital. Not less than \$100,000,000.

2. Ownership. To popularize the measure, receive voluntary subscriptions from national and state banks in sums of not less than 5 % or more than 10 % of the capital of each. Any stock not taken voluntarily by banks, should be offered to the public, but in no case should any bank or individual acquire or hold more than one one-thousandth part of the entire stock, or less if thought best, in order to prevent monopolistic control. The government ought not to contribute, because without such contribution political interference would be practically eliminated.

3. Management. There should be a board of twenty-five directors, without pay, except expenses and \$10 to \$25 a day for attending quarterly or semi-annual meetings. Six directors should go out each year, making the term of service four years. The secretary of the treasury should be the twenty-fifth director.

4. Business. If it is thought best not to abolish the present United States treasury system (probably an impolitic thing to attempt to do) then all surplus funds of the government in excess of normal daily requirements might be deposited in the national reserve bank. The banks of the three central-reserve cities might also deposit part of their required cash reserves. All should be counted as reserves just as under the present law, but no interest should be paid on deposits of any nature, thus practically eliminating competition with existing banks. The bank should have the right to issue \$100,000,000 of untaxed notes, any excess to pay 5 % on conditions similar to the Imperial Bank of Germany.

5. Loans. Existing banking privileges should not be disturbed. I see no reason why the reserve bank should not purchase and hold its full capital and surplus, also part of its

untaxed currency issues in United States, county or city bonds, such as are permissible under the New York and Massachusetts savings-bank law. Generous reserves should be held against deposits and the balance loaned on quickly-convertible paper. No loans should be made on stocks as collateral, thus giving no aid to stock gambling. As for elasticity, the untaxed currency could be used to move the crops and the taxed to meet abnormal pressure. If the reserve bank made extra loans to relieve pressure, their repayment in reserve-bank or other notes would effectively and automatically impound excessive issues without any expensive redemption machinery whatever, thus preventing inflation and its concomitant evil, the exportation of gold in accordance with Gresham's law.

6. Limitation of earnings. A surplus fund should be gradually accumulated up to 20 % of the capital, and semi-annual dividends declared. One-half of the excess over 4 % dividends should be paid into the United States treasury, until 5 % or 6 % was paid to stockholders; thereafter all excess profits should be covered into the United States treasury. Such government profits might be in lieu of any taxation upon the bank. These conditions would insure dividends and government profits from the start.

Such a reserve bank ought to be confined to dealings with banks alone. No branches are needed. If we had had such a bank in 1907, solvent banks in New York having ample collateral could have obtained cash through discounts at the bank of issue. If so, such notices as "No cash will be paid on balances," would not have been flashed to the country. The simple philosophy of "You got 'em, I no want 'em," would have applied and general suspension would have been avoided. What we need is a reservoir from which to quench the conflagration in its incipiency. We want a bank, not to monopolize the necessary banking function or enter into competition with our splendid independent banking system, but to be our servant in time of trouble, to prevent cash suspensions with their paralyzing train of evils.

It is objected that "all banks would be compelled to rediscount their paper with the national reserve bank." The Wau-

kesha National Bank has had no occasion to rediscount for over thirty years, except in panic periods to prevent cash suspension. Even in 1907 it paid cash on all demands. The 14,000 millions of dollars on deposit in the banks of the United States today are evidence that surplus capital is abundant, and that most banks need small rediscounts under normal conditions. As conclusive proof, in 1907 the loans, discounts, bonds, and other like assets held by all the banks of the country aggregated about 16,000 millions of dollars. The total rediscounts and money borrowed by all the banks approximated about 150 millions of dollars, or less than 1 % of the total, notwithstanding the fact that most of the central-reserve-city banks offered such accommodations to their country correspondents.

In the new west and south, where surplus capital is not abundant and crops are largely confined to one staple, some banks need assistance in the fall to move the crops, but in the greater part of the country, where crops are diversified and surplus capital predominates, bankers rarely know when crops move, the cry to the contrary notwithstanding. There would be no fear of the central bank monopolizing country or city bank balances, because it is conceded that the central bank would not be allowed to pay any interest on balances, and thus the existing conditions between country and city banks, the latter paying 2 % on balances, would be voluntarily maintained.

Lastly, some people honestly fear monopolization, and they cite the old United States Bank, which met its doom in 1836, as an example. So far as I know, all advocates of a central bank are opposed to an institution similar to the old United States Bank, which had branches in nearly all the large cities of the country and threatened to monopolize the general banking function of taking deposits and making loans, as well as that of issuing currency. That bank was justifiably legislated out of existence. The kind of bank now suggested is one acting only as a safety valve, limited in its general banking function, but principally acting as servant to our splendid independent banking system, and not as its master, a bank to assist other banks in moving crops, if necessary, and to prevent solvent banks from cash suspension in time of panic. With practical limitations, monopolization would be unprofitable and practically impossible.

Solvent farmers, merchants or manufacturers with ample assets continually find ready assistance at the banks, that bills due may be promptly honored and high credit maintained. The bank is their reservoir in the day of trouble. Why should not all solvent banks, national, state and others, with portfolios filled with good assets, have some reservoir where cash could be had quickly when distrust threatens, when reserves are limited, and when frightened people are clamoring for their deposits? Why should the banks not be in a position to loan to all solvent parties, that payrolls be not discontinued or the wheels of commerce stilled? Why should the banks in Milwaukee, Chicago and New York, which in 1907 held \$300,000 of the reserves of the bank of which I have the honor to be president, be denied the privilege of such a reservoir of cash, that our reasonable cash requirements be promptly met? Why should we be floundering about under general cash suspensions, as in 1907, at a cost of thousands of millions of dollars to labor and capital alike, when relief could be had through a national reserve bank?

I am confident that such a bank could be chartered free from political or monopolistic control. It would prevent cash suspensions, prevent high interest rates, prevent hoarding of cash at all times. It would work quietly and automatically, whereas relief through clearing houses has a tendency to breed distrust through exciting general public comment. Is it not wise to adopt that method which is simple, direct and automatic in its action, and which is approved by the experience of nearly all the progressive countries of the world?